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ARIZONA CORPORATION COMMISSION
OFFICE OF COMMISSIONER BOYD DUNN

June 17, 2020

Docket Control
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Re: In the matter of the rate review and examination of the books and records of Arizona Public Service Company and its affiliates, subsidiaries and Pinnacle West Corporation (E-01345A-19-0003); In the matter of the application of Arizona Public Service Company for a hearing to determine the fair value of the utility property of the company for ratemaking purposes, to fix a just and reasonable rate of return thereon, to approve rate schedules designed to develop such return (E-01345A-19-0236).

Dear Chairman Burns and Commissioners:

I appreciate Chairman Burns' proposal related to interim rates and look forward to discussing it at the Special Open Meeting. In preparation for that discussion, I wanted to raise the idea of a performance-based rate design (PBR) for consideration by the Commission in the pending rate case. I believe this approach would be an effective way to address Arizona Public Service Company's (APS or the Company) continuing disregard for customer outreach, education, and satisfaction.

I want every utility's priority to be the customer above all else. Most of our utilities have their business practices and corporate mission centered around this principle. APS has not, and their failures in customer service and communications are well documented. As a Commission, we have struggled to find a legal pathway to make this utility put customers first. The Commission has already determined that APS failed to implement an adequate customer education and outreach program following the last rate case. In response, the Commission ordered APS to fix it and retain a third-party expert to oversee the customer education and outreach program. Even with this oversight, our expectations have not been met. It is time to consider a new approach to force compliance.

Because APS is currently in the middle of a rate case, I believe the most effective legal approach is to use its rate-setting authority to align the interests of customers with the interests of the Company's bottom line. I believe a PBR structure could be crafted in such a way that is consistent with the fair value requirement as interpreted in *Phelps Dodge Corporation v. Arizona Electric Power Cooperative*, 83 P.3d 573, 207 Ariz. 95 (App. 2004). To that end, it is time for the Commission to consider if it is just and reasonable to tie APS' return on equity to customer satisfaction, education, and outreach.

Arizona would not be first to try this approach. Illinois, New York, and Massachusetts have implemented performance-based ratemaking already and 19 total states and D.C. are considering PBR measures. Traditionally, PBR has been deployed to set performance metrics that address areas with historically poor performance, areas where the utility could operate more efficiently or reduce costs, and areas

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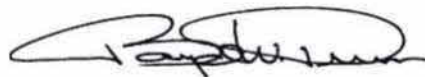
where the regulator wants to encourage the adoption of new policies. What is consistent across all performance-based rates structures are clearly defined metrics, targets, and financial consequences to eliminate any unintended consequences, gaming, and manipulation. Metrics must be quantifiable, objective, tracked, reported, and independently verified. The metrics should be based on actions that are completely within the control of the utility and the targets must be realistic.

I would like to discuss PBR tomorrow in a little more detail, knowing that this is just the beginning of the conversation. Additionally, I would like the parties to the pending rate case to consider and present evidence on whether a penalty or incentive-based ROE that is tied to meeting specific customer satisfaction, education, and outreach metrics is just, reasonable, and in the best interest of ratepayers. The evidence presented should weigh pros and cons of moving to this type of a rate design and discuss possible scenarios for a performance-based metric. Specifically, I would like the parties to (1) identify the scope of the customer satisfaction, education, and outreach problems, (2) propose and discuss possible metrics for tracking and reporting performance on customer satisfaction, education, and outreach (3) propose and discuss performance targets, and (4) propose and discuss the financial penalty structure.

I would also like evidence in the record so the Commission can consider whether the JD Power and Associates customer satisfaction rankings would be a useful metric, and furthermore, what would the appropriate ROE percentage be to start and how should it scale when performance metrics are met, and over what period of time. These are specific topics I would like the parties to address, but should by no means limit the discussion or consideration of available options.

I look forward to discussing this issue tomorrow and reviewing the evidence presented by the parties in the pending rate case.

Sincerely,



Boyd Dunn
Commissioner

